DOW THEORY LETTERS INC.

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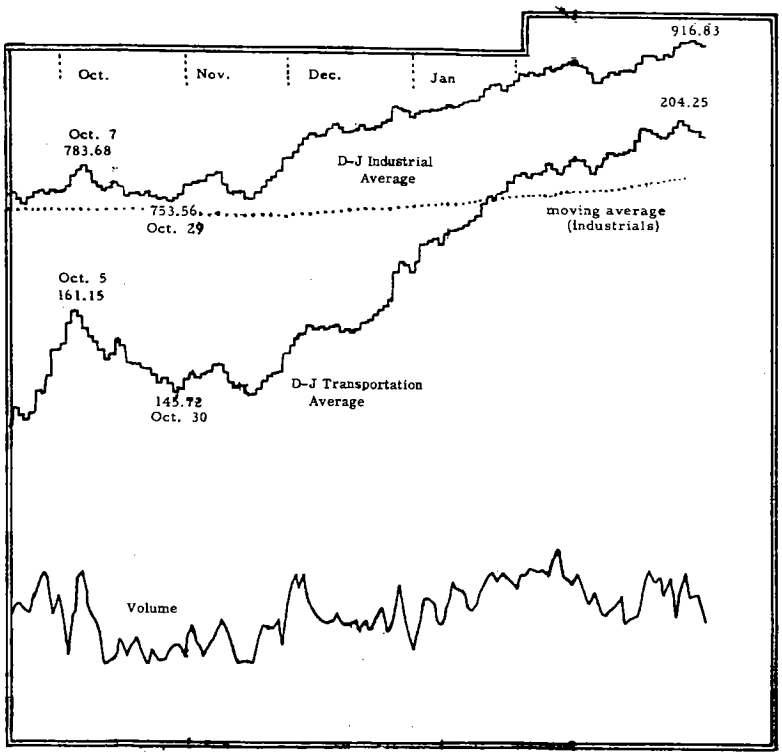
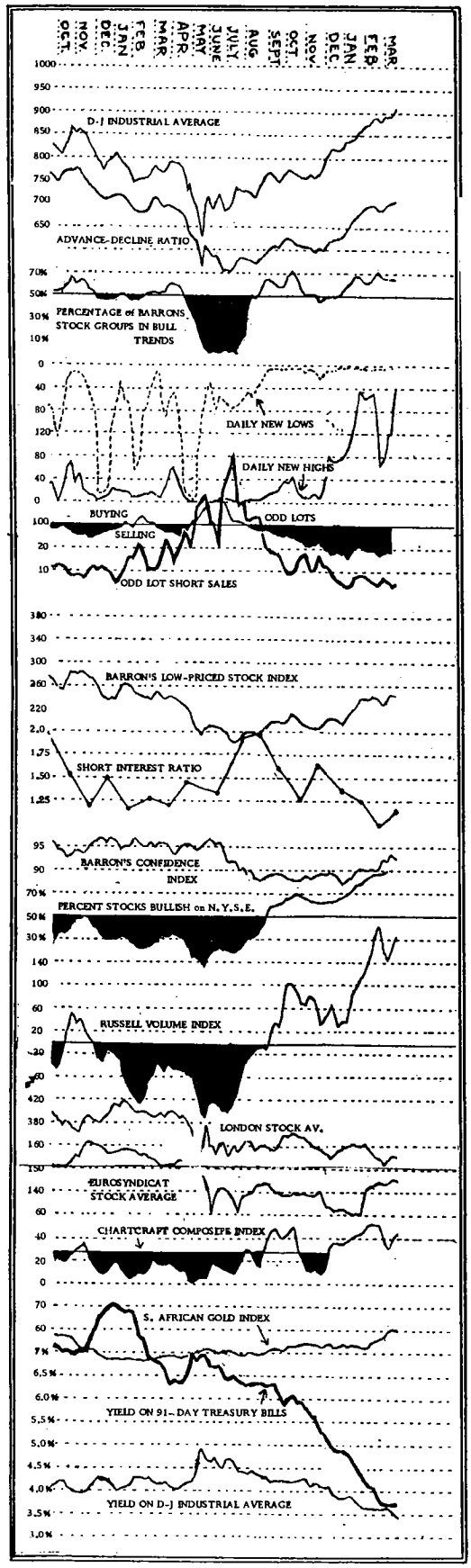
THE PICTURE: When President Nixon took office, I wrote that in my opinion he had two main jobs; the first was to tell the truth about Vietnam, and the second was to tell the truth about the economy. To face the real truth about a situation is the beginning of taking correct action on a situation. To avoid the truth of a situation, and then to take action on those half-truths and lies, is to sink further and further into the morass of confusion, evil and ultimately - disaster.

The President "said" we had to get out of Vietnam, but he obviously wanted a few "victories" on the way to actual departure. Our "victories" are now appearing, and our troops are still there. The victories are taking the form of horrendous war-crime court cases, new ones to come, PX scandals, unbelievable expenses and the latest, a sorry retreat from Laos with the possibility that history will view the Laotian "campaign" as at best a mistake, at worst a senseless defeat.

On the economic front the "full-employment budget" may be the crowning irony in the Administration's effort to avoid the facts. Already, an increasing number of top economists are warning that the $1,065 billion Administration goal for the economy will not be met. Industrial production declined in February, personal income dropped in February to half the average increase of 1970, and housing starts barely edged up. On March 17, Alan Greenspan (my choice for the most informed advisor to the President's Council of Economic Advisers) stated that he doubted that the $1,065 GNP goal for 1971 will be reached. Greenspan added that even at a 4% rate of inflation, the U.S. economy would do no better than stand still.

If the economy (and profits) falls considerably short of the full-employment budget, the $11.6 deficit (which was "programmed" by the Administration)





could climb to $20 to $30 billion or more. With every city, country and state shouting for Federal funds, and with the specter of the Federal Government itself falling far short of funds, 1971-72 shapes up as some sort of climax in deficit-productions and budget-shambles!

On March 18 the Department of Commerce announced that pretax corporate profits for the last (strike) quarter of 1970 dropped to an adjusted, annualized rate of $77.5 billion, down from the $88.5 billion rate of a year earlier. For full year 1970 pretax profits dropped to $81.6 billion from 1969's $91.2 billion. The almost $10 billion drop was the greatest since World War II. To reach the Administration's forecast of $98 billion for the current fiscal year, profits will have to rise 20%. This in the face of very sluggish capital spending, continuing consumer caution and a probable steel strike later this year (to say nothing of the possibility of major and wide-sweeping trouble brought on by a possible Lockheed bankruptcy).

As I see it, economic troubles of massive and unhandable proportions are brewing, troubles that should emerge before the end of this year. But even before any actual economic troubles, I believe we are going to see fireworks on the monetary front.

In view of that line of reasoning, I have included a large section in this Letter on gold and the international monetary situation. Presently, all gold shares listed on the N.Y.S.E., Canada and South Africa are in powerful upmoves, with their prices above anything seen since 1969. Significantly, the current gold move is occurring simultaneously with the upward correction in the market (rather than the usual gold rise as the stock market declines). The real gold rise, I feel, will come when the market does start down. Today's gold rise is only the preview.

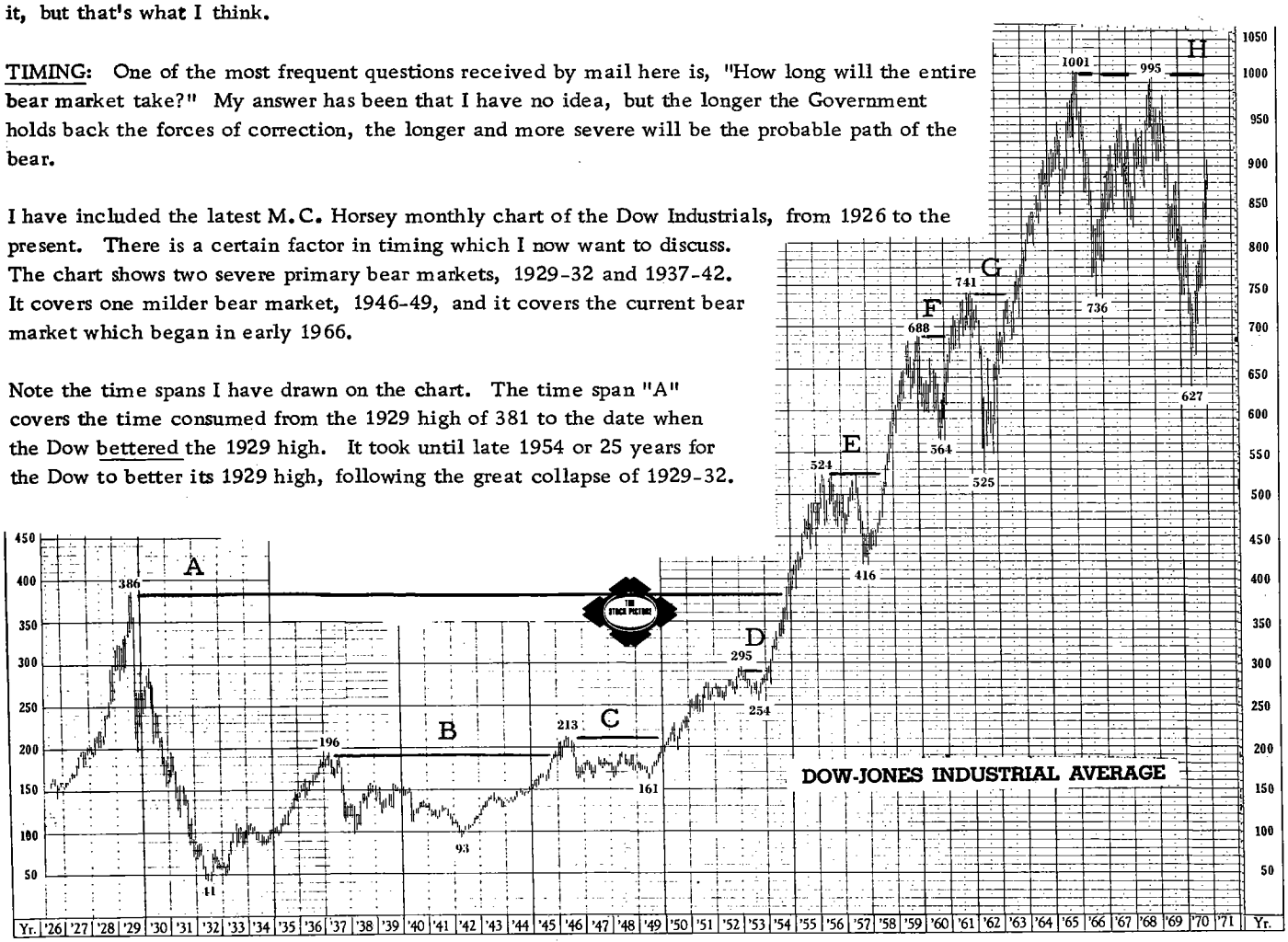
Meanwhile, back on Wall Street the market is continuing to inch higher, but the bettering of the 900 level on the Dow seems to have brought on more labored action on the upside than anything seen since last November. The Transportation Average set a recovery high of 204.24 on March 15, and I would use the March 16 closings as the last joint high levels of the Averages until proved otherwise (meaning, until or unless Transports climb above 204.25). It is worth remembering that under Dow Theory, a movement terminates at the point where the Industrial and Transportation Averages record their last joint highs.

Incidentally, as stated before, I do not think there is going to be any secondary correction of this rise. My guess is that when the Averages start down, that is going to mark the beginning of the next major primary bear leg. Obviously, I can't prove it, but that's what I think.

TIMING: One of the most frequent questions received by mail here is, "How long will the entire bear market take?" My answer has been that I have no idea, but the longer the Government holds back the forces of correction, the longer and more severe will be the probable path of the bear.

I have included the latest M.C. Horsey monthly chart of the Dow Industrials, from 1926 to the present. There is a certain factor in timing which I now want to discuss. The chart shows two severe primary bear markets, 1929-32 and 1937-42. It covers one milder bear market, 1946-49, and it covers the current bear market which began in early 1966.

Note the time spans I have drawn on the chart. The time span "A" covers the time consumed from the 1929 high of 381 to the date when the Dow bettered the 1929 high. It took until late 1954 or 25 years for the Dow to better its 1929 high, following the great collapse of 1929-32.



Now within that quarter century which was consumed prior to the Dow bettering its 1929 high, there were two lesser bull markets and two bear markets. Following the 1937 bull market peak of 194 (see "B" on chart), it took eight years or until late-1945 for the Dow to better its 1937 peak. Turning to the 1946 bull market top of 212, it required four years or until early 1950 (see span "C") for the Dow to better the 212 1946 high, even though the 1946-49 bear market was a relatively mild one.

Thus we can see that the time span is significant following primary bull market tops. It took 25 years to better the 1929 high, 8 years to better the 1937 high and 4 years to better the 1946 high.

Next we come to the bull market which began in June, 1949. This was to be one of the greatest primary bull markets in history, punctuated with numerous severe reactions. But note the difference in the time spans to new highs following each reaction. The force of the primary bull market shortened the time span to new highs considerably.

First we have the reaction of 1953 ("D" on chart). A period of 13 months elapsed before the Dow, in February, 1954, bettered its 1953 peak of 293. Next we have the severe correction of 1956-57, which took the Dow from 521 to 419. The time span for recovery to new highs ("E" on chart) was 2 years and 4 months. In January, 1960, the Dow touched a high of 685, then went into a correction to 566 that year. The time span for recovery to new highs ("F" on chart) was 15 months or to April, 1961.

On December 13, 1961, the Dow recorded a high of 734, then dropped rapidly to 535 in 1962. The time span ("G" on chart), despite this drastic correction, was 1 year and 5 months — or until May, 1963.

Finally, we come to the bull market peak of 995.15, recorded in February, 1966. This was the point at which I stated that the entire bull market topped out. Despite two major declines (the first to 744 in 1966, the second to 631 in 1970), and despite two major recoveries, the second of which is now in progress, the Dow has failed to better its 1966 bull market high of 995.15.

But it is the time span ("H" on chart) which is so interesting. It has been 5 years and 1 month since the 1966 bull market high, and the Dow has persistently failed to pass the 995 level. Therefore, the current time span "H" has been surpassed only by the 25 years following 1929 and the 8 years following 1937.

This is the kind of time span we would expect during a primary bear market, not following a bull market correction. But the incredible thing is that here, 5 years after the top, we find the Dow still 100 points from its high. The time span of 5 years says it is a bear market, the fact that the Dow is within 100 points from its high says that this bear market has a long way to go on the downside and a dreadful amount of correcting to do.

THE STORM CLOUDS: Across the face of the Free World a storm is brewing, and even the national periodicals (see newsclips page 4) are getting whiffs of it and presenting it to readers. The storm center is the new, massive pile-up in dollars overseas, and the new mood of the U.S.'s overseas creditors. The new mood is one of anger, frustration, and in an increasing number of cases — action. For while the U.S. follows its "head-in-the-sand" policy of monetary expansion, roaring inflation and deficits, sundry foreign central banks are beginning to call in gold. Thus the Netherlands recently called in $25 million in U.S. gold, Switzerland purchased $75 million in gold, and Germany is negotiating to buy $500 million in U.S. gold. Japan is reported desirous of purchasing U.S. gold, and with last week's insulting turn-down of the Japanese voluntary taxtile quota offer by Mr. Nixon, Japanese tempers may be reaching the "call-for-gold" level. (It might also be mentioned that Japan's gold reserves are entirely too small, being $532 million in gold against total reserves of $4.5 billion or only 11.7% in gold).

A few weeks ago, in fact, the Common market announced officially that it had absorbed $12 billion in the last 14 months, $2 billion of that since the first of the year 1971! Meanwhile, in Germany (which refused to lower its "Lombard rate" or bank rate as it pursues its fight against inflation), the situation was worsening almost daily as hundreds of millions of dollars poured into Europe's economic bastion.

The accompanying chart from the Federal Reserve Chart book (see page 5) tells part of the story. Note what has happened to the total of liquid liabilities to foreigners since January, 1969. That figure has rocketed from around $33 billion to $44 billion. And as seen on the chart, this great rise has been to "official institutions" (central banks) which have gained approximately $10 billion of U.S. liabilities (dollars).

BARRON'S, MARCH 15, 1971

Another Day, Another Dollar?

The U.S. Can't Afford to Be Complacent About Its Finances

EVENTS, so the saying goes, tend to cast their shadows before them; where money is involved, chances are good that they will make their presence felt in one or another of the world's markets. On this score, several of the latter in recent weeks again have been showing signs of disquiet over the state of the American dollar. In the major foreign exchange centers, notably London, Paris, Brussels and Zurich, the dollar has been flat on the "floor" (lowest level at which, under the rules of the International Monetary Fund, it can trade in terms of local currencies). The Financial Times (London) Index of South African Gold Shares, also known as Kaffir- recently made

ments in favor of devaluation. In early November, the European Economic Community, largest and formerly most patient U.S. creditor of all, issued the bluntest warning. The spokesman for the Common Market who voiced it chose to remain nameless; otherwise, he laid things on the line. U.S. efforts to achieve full employment by 1972, the "high official" said, "would mean an unacceptably high rate of inflation and a large balance-of-payments deficit. It would be difficult for European monetary authorities to explain to (their) public that they were accumulating dollars with

Last week another Swiss banker raised a more critical voice. In Basel, Samuel Schweizer, president of Swiss Bank Corp., told a stockholders' meeting that excessive allocations of Special Drawing Rights and last year's $7½ billion increase in IMF quotas are closely linked to world inflation. He noted that early this year, fresh SDR allocations totaling $3 billion were made. "The fact that the allocation is continuing in spite of a record American balance-of-payments deficit is a clear-cut abuse of this

creating a finance dollar of its own. The world of international commerce, Dr. Kriz warned, would be back where it was in the 'Thirties.

Morgan Guaranty Trust Co. has struck an equally somber note. In the Morgan Guaranty Survey for February, Dr. Robert Triffin, Professor of Economics and master of Berkeley College at Yale University, termed U.S. official policies in the realm of international finance a "utter failure." The

Business Week

March 13, 1971

ECONOMICS

Nixon's expansion policy irks Europeans

Central bankers complain that the payments deficit hurts them and imperils the dollar

"The Nixon economic policy? It's just inflation called expansion." This tone of sarcasm from a key central bank economist shows how Europeans have changed their attitude toward the U.S. dollar—and toward the economic policies of the Nixon Administration.

Last year, the hope was tha U.S. would lead the world out of flationary spiral. Tight money a strictive fiscal policies had produ business slowdown that, most e

adopted this stance, and official economic policy statements have always included at least some reference to the continuing payments problem. But the President's Council of Economic Advisers has come close enough in its own analysis for Europeans to begin to read past the disclaimers.

Federal Reserve Chairman Arthur Burns and Treasury Secretary John Connall for dollar

European experts professed to be largely indifferent to the worsening of the U.S. balance of payments as measured by the official settlements method. Most of the change was caused by the return flow of Eurodollars as monetary conditions eased in the U.S. and tightened in Europe. Now, looking at the same figures, one high Italian official declares that "if this does not improve strongly, the world monetary system will be shaken to its founda- of this year."

Meanwhile, the situation is further deteriorating as U.S. interest rates drop. With the U.S. bank discount rate at 4.75%, it is notable that the discount rates of Britain, Belgium, France, Germany and Holland are all at 6% or more. The current low yield on U.S. Treasury bills is hardly attractive when pitted against higher-yielding foreign short-term instruments, so that in the short-term area too, dollars are leaving the country.

Last week I spoke to a man who I consider one of the most knowledgeable on gold and currency in the country. He told me that he considers the gold-dollar situation very

DUN'S REVIEW

DUN'S

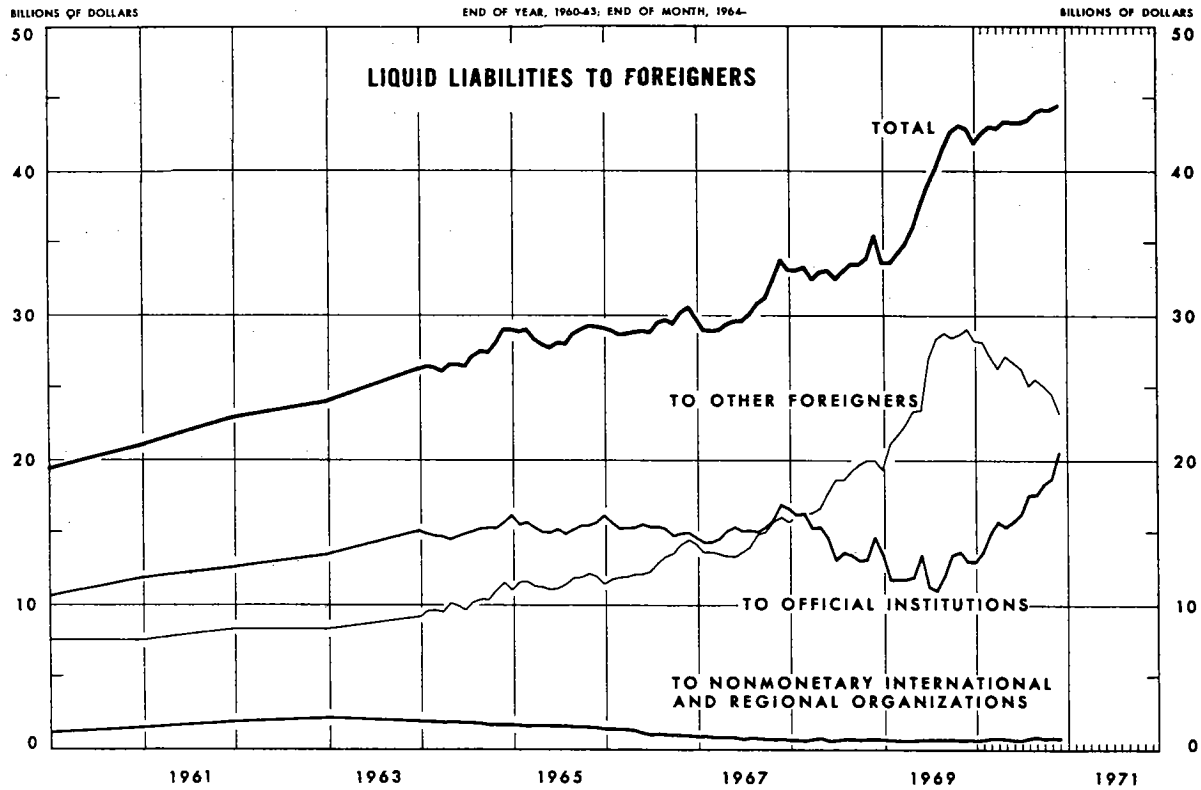
MARCH 1971, Volume 97, No. 3

New Troubles for the Dollar?

European moneymen are worried—and frustrated.

LONDON—It's a little like the rainy, late winter weather in this European capital. Everyone is complaining but no one knows what to do about it. It's the dollar. When in mid-1970 Eurodollars began to stream back across the Atlantic—having played a brief but effective role in easing the U.S. credit crunch of 1968 and 1969—Europe's moneymen began to worry. Since then, their

One reason, of course, is that the U.S. seems to have eased up on its fight against inflation. "Personally," agrees Yassukovich of White Weld, "I believe that people are less concerned with the cold statistics of the balance of payments than with the erosion of the purchasing power of the dollar in the U.S. The main crisis of confidence is coming from the fact



grave and nearing a possible crisis level. The U.S. has unofficially informed Europeans that it will never let its gold reserves drop below $10 billion. The current U.S. gold reserve is thought to be around $11 billion. In other words, we are getting precariously close to the point of a "gold embargo," and indeed this gentleman believes that the actual date for a gold embargo may already have been set. One such date, he informed me, may be the Easter weekend of next month.

Next, he furnished me with some statistics which proved so fascinating to me that I want to include a few of them here. The following tabulations show the amount and percentages of gold, I. M. F. reserves and foreign exchange held by the Common Market nations during the years 1960, 1969 and 1970.

	TOTAL PRIMARY RESERVES	GOLD	I.M.F. RESERVES	FOREIGN EXCHANGE
1960	$15.9 Bils.	$9.4 Bils. or 59%	$785 Mils. or 4.9%	$5.7 Bils. or 36%
1969	$20.8 Bils.	$13.8 Bils. or 66%	$1.76 Bils. or 8.4%	$5.3 Bils. or 25%
1970	$29.9 Bils.	$13.6 Bils. or 45%	$2.12 Bils. or 7.1%	$13.3 Bils or 44%

In other words, gold as a percentage of total primary reserves among the Common Market nations is dropping rapidly. And at the same time, foreign exchange (mostly dollars) is rising as a percentage of total primary reserves. This tends to put the Common Market nations in the position of being "satellites" of the U.S., since almost half of their total reserves are now in dollars. And they are in dollars which are being steadily eroded in value via U.S. induced inflation.

The U.S. policy has been literally to ignore the balance-of-payments deficits, to ignore the inroads of inflation, and to ignore the pile-up of unwanted dollars overseas. Meanwhile, the U.S. has been pressing for a revaluation upwards of foreign currencies while holding the value of the dollar in a fixed relationship to gold. In other words, instead of devaluating the dollar in terms of gold, the U.S. has been pressuring other nations to "up-value" their own currencies in relation to the dollar and gold.

Personally, I feel that re-valuation pressures will not be successful from this point on. The reason is that the boom is drawing to an end in Europe, and that hard competition has taken its place. When a foreign currency is re-valued upwards, it means that businessmen in those countries must pay more for imports while receiving less for what they sell and ship out of the country (exports). I don't believe that Germany, Japan, or any other country is going to stand for re-valuation upwards of their currencies with business at its current difficult competitive levels. Re-valuation upwards may have helped the U.S. a few years ago, but I do not see any foreign countries helping the dollar out with re-valuation now.

So in my mind, the crisis of the dollar is now closer than ever before. Any brick pulled out from under the shaky U.S. currency edifice could set off the whirlwind of a U.S. gold embargo and international monetary chaos. To give an example, oil-rich Libya at the end of 1969 had a total of $918 million in reserves of which $85 million was in gold and $828 million was in foreign exchange (mostly dollars). At the end of 1970, Libya had a total of $1.59 (!) billion in reserves of which $85 million was still in gold and $1.49 billion was in foreign exchange. Question: How long will Libya resist turning a chunk of its $1.49 billion in for gold?

Second case in point: Germany is now piling up with dollars. On February 22 alone Germany took in $300 million dollars as reserves rose to $15.0 billion. The situation became so bad that the Federal Reserve Bank in New York (for the first time) started selling forward Deutschesmarks. This was done in order to hold the price of marks down in relation to dollars, and it amounted to short-selling the mark in order to drive it down. But these forward marks will have to be covered in a few months, with the U.S. thus facing the same situation again.

The U.S., in the face of all of this, has only three answers. The first is Mr. Arthur Burns of the Federal Reserve Board. I believe that Burns is fully aware of the ominous situation, and that there is probably a limit to how long he will stand pat in the face of the gathering crisis. But in order to move to defend the dollar, Mr. Burns must take a stand in direct opposition to the Administration. The time for such a stand is growing very late. As far as Mr. Connally of the Treasury is concerned, I write him off as being just another Administration spokesman. I saw his performance last week on the "Face the Nation" TV-cast, and it can be summed up as wishy-washy and "wait 'n see".

The second "answer" is U.S. pressuring of foreign creditors not to call in gold. This pressure takes the form of various threats such as the threat of embargo if gold is called, the threat of pulling our troops out of various countries if they don't sit pat with our dollars, the threat of loss of U.S. financial aid, etc. This answer, to my mind, is entirely unsatisfactory, and must be entitled "manipulation through power". It won't work forever, and indeed, I doubt if it will work much longer.

The third "answer" is monetary manipulation, and under this title I place all stop-gap measures such as the SDR's (which are losing favor among foreigners already), short selling and swapping of foreign currencies, paying off gold claims with U.S. I.O.U.'s, etc. This answer, I also feel, is running out in terms of effectiveness.

After reading all this, the reader will surely ask, "What happens if the U.S. embargoes gold?" Well, frankly, I haven't the answer, because I've nothing to go on. As far as I'm concerned, if the U.S. embargoes gold it is tantamount to declaring international bankruptcy. I say this because dollars have been held overseas always with the understanding that they were "as good as gold". Those dollars represent a claim on a thirty-fifth of an ounce of U.S. gold. An embargo is a statement that the claims cannot or will not be paid off.

The situation is much like that of a business worth $1 million which has $2 million worth of short term debts outstanding. I don't care how the business is doing profitwise, if its creditors start rushing to collect their money that business is going bankrupt. And of course the thing that will cause the creditors to grab for their cash is almost always loss of confidence. In my opinion, the U.S.'s creditors are very close to that stage now.

If a gold embargo is called, creditors overseas will be stuck with upwards of $20 billion which cannot be turned in for gold. I would imagine that a certain percentage of those creditors will start unloading dollars for whatever any market will bring. The price of gold would soar in relation to the dollar, and international monetary chaos would probably reign for weeks or months. The dollar would be subject to a supply-and-demand situation on the international market, and international trade would be subject to fears and doubts as the world's reserve currency topples from its throne.

These are some of the storm clouds I see gathering as we go into the second quarter of 1971. The way matters are developing, I don't see us getting through the year without the gold issue rising to confront the U.S. and forcibly yanking its monetary "head" out of the sand into which it has been hiding for the last decade.